

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 02-0501
Indiana Corporate Income Tax
For 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Exclusion of Taxpayer's Telemarketing Subsidiary from Taxpayer's Consolidated Adjusted Gross Income Tax Return.

Authority: IC 6-3-2-2(a); IC 6-3-2-2(l); IC 6-3-2-2(m); IC 6-3-4-14(a); IC 6-3-4-14(b); 45 IAC 3.1-1-38; 45 IAC 3.1-1-110; 45 IAC 3.1-1-111.

Taxpayer argues that the Department of Revenue (Department) erred when it excluded taxpayer's telemarketing subsidiary from taxpayer's consolidated adjusted gross income tax return. Taxpayer maintains that, by virtue of the telemarketing subsidiary's activities within the state, it has established an Indiana nexus and that the telemarketing subsidiary should have been included in the calculation of its Indiana adjusted gross income.

STATEMENT OF FACTS

Taxpayer is an affiliated group of companies engaged in the funeral and cemetery business. Taxpayer submitted consolidated Indiana tax returns reporting its state income tax liabilities. The Department conducted an audit review of these returns making a number of adjustments. Included among those adjustments was a determination that taxpayer's telemarketing subsidiary should not have been included in the 1998 consolidated return. The decision to eliminate the telemarketing subsidiary had the result of increasing taxpayer's state income tax liability. Taxpayer challenged the decision resulting in various communications between the Department and the taxpayer the net result of which was that the Department declined to reverse its original decision excluding the subsidiary. Taxpayer submitted a protest, an administrative hearing was conducted during which taxpayer further explained the basis for its protest, and this Letter of Findings results.

DISCUSSION

I. Exclusion of Taxpayer's Telemarketing Subsidiary from Taxpayer's Consolidated Adjusted Gross Income Tax Return.

Taxpayer is a multi-state company which supplies consumers with funeral and cemetery services. As part of that business, taxpayer owns an out-of-state telemarketing subsidiary which

sells consumers pre-need insurance policies. The telemarketing subsidiary has an Indiana business location which – during the relevant period and at various times – employed between one and seven part-time employees. These employees earned approximately \$17,000 in total wages during 1998.

The telemarketing subsidiary conducts its Indiana operation from a location owned by one of taxpayer's other subsidiaries. The telemarketing company does not own any real property in Indiana. Taxpayer has submitted evidence indicating that telemarketing subsidiary owns approximately \$1,000 worth of office furniture at the Indiana location. Taxpayer has submitted information indicating that the Indiana telemarketing subsidiary was "charged" with purchasing computer software containing residential telephone listings. This software cost approximately \$2,700.

Taxpayer's telemarketing business works like this:

1. Telemarketing subsidiary hires part-time employees who work out of borrowed office space.
2. Telemarketing subsidiary's employees call Indiana residents soliciting the sale of pre-need insurance policies.
3. If the recipient of the phone call expresses interest, the telemarketer will send the prospective customer an insurance policy application form. The telemarketer does not sell the insurance policy; the telemarketer opens up the possibility that the prospective customer will complete the application and buy insurance from the related insurer.
4. Prospective customer sends a completed application to related insurance company. Related insurance company then decides whether to accept the application. If it does, the transaction is completed, one of taxpayer's local funeral homes is designated the beneficiary, and customer sends premium payments to related insurer.
5. Once related insurer begins to receive the insured's payments, the related insurer owes taxpayer a commission by virtue of the fact that telemarketing subsidiary solicited the sale of the underlying insurance policy.
6. Yet another of taxpayer's subsidiaries – acting as common paymaster – receives and then forwards the commissions to the individual telemarketer who originally invited the sale.

Therefore, telemarketing subsidiary's Indiana business consists of hiring part-time employees who facilitate the sale of insurance policies sold by a related insurer. In consideration of a completed sale insurer pays commissions to taxpayer's common paymaster subsidiary which then forwards those commissions to the originating telemarketer. Telemarketing subsidiary owns personal property consisting of office furniture and computerized phone lists.

The issue is whether taxpayer was correct when it decided to include the telemarketing subsidiary in its consolidated state income tax return.

IC 6-3-4-14(a) provides that, “An affiliated group of corporations shall have the privilege of filing a consolidated return with respect to the taxes imposed by IC 6-3.”

The Department’s regulation states that, “An affiliated group as defined in IC 6-3-4-14(b) may file consolidated returns for Adjusted Gross Income Tax and Supplemental Net Income Tax” 45 IAC 3.1-1-110. The term, “affiliated group,” is defined at 45 IAC 3.1-1-111 which provides that “The Adjusted Gross Income Tax Act adopts the definition of ‘affiliated group’ contained in Internal Revenue Code Section 1504, except that no member of the affiliated group may be included in the Indiana return unless it has adjusted gross income derived from sources within the state, as that phrase is defined in IC 6-3-2-2.”

I.R.C. § 1504 defines, among other things, the degree of ownership which must exist before related businesses can be considered to be members of a federal “affiliated group.” For purpose of this discussion, it will be assumed that taxpayer owns the telemarketing subsidiary and that there are no I.R.C. “ownership” questions which otherwise affect parties qualifications to be included as members of a federal “affiliated group.”

However, qualifying under I.R.C. § 1504 – standing alone – is not sufficient to qualify the related businesses to file an Indiana consolidated tax return. In this situation, the telemarketing subsidiary must have received “adjusted gross income derived from sources with the state, as that phrase is defined in IC 6-3-2-2.” 45 IAC 3.1-1-111.

IC 6-3-2-2(a) provides as follows:

With regard to corporations and nonresident persons “adjusted gross income derived from sources with Indiana”, for purposes of this article, shall mean and include:

- (1) income from real or tangible personal property located in this state;
- (2) income from doing business in this state;
- (3) income from a trade or profession conducted in this state;
- (4) compensation from a trade or profession conducted in this state; and
- (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

The Department’s regulation sets out a definition for “doing business” within the state. The regulation states:

For apportionment purposes, a taxpayer is “doing business” in a state if it operates a business enterprise or activity in such a state including, but not limited to:

- (1) Maintenance of an office or other place of business in the state
- (2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
- (3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution
- (4) Rendering services to customers in the state
- (5) Ownership, rental or operation of a business or of property (real or personal) in the state
- (6) Acceptance of orders in the state
- (7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L. 86-272 to tax its net income. 45 IAC 3.1-1-38.

Presumably, taxpayer maintains that the telemarketing subsidiary is “doing business” within Indiana because the subsidiary’s employees makes phone calls from “an office or other place of business in the state” or because it is “[r]endering services to customers in the state.” Id. However, even if taxpayer was able to demonstrate that telemarketing subsidiary earned its money from doing business within the state and even if taxpayer was able to demonstrate that its borrowed office space and part-time employees established the requisite Indiana nexus, the audit would have been justified in eliminating the telemarketing subsidiary from the consolidated return in order to more fairly reflect taxpayer’s Indiana income. IC 6-3-2-2(l) provides as follows:

If the allocation and apportionment provisions of this article do not fairly represent the taxpayer’s income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer’s business activity, if reasonable;

- (1) separate accounting;
- (2) the exclusion of any one (1) or more of the factors;
- (3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer’s income derived from sources within the state of Indiana; or
- (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer’s income.

In addition, IC 6-3-2-2(m) provides:

In the case of two (2) or more organizations, trades or businesses owned or controlled directly or indirectly by the same interests, the department shall distribute, apportion, or allocate the income derived from sources within the state of Indiana between and among

those organizations, trades, or businesses in order to fairly reflect and report the income derived from sources within the state of Indiana by various taxpayers.

IC 6-3-2-2(l), (m) provides the Department discretionary authority to adjust the allocation and apportionment provisions of the adjusted gross income tax in order to arrive at an equitable and accurate allocation of the taxpayer's Indiana income. The goal is to "fairly reflect . . . the income derived from sources with the state" IC 6-3-2-2(m).

The telemarketing subsidiary has only a tenuous connection with this state. The telemarketing subsidiary did not own any real property in the state, owned a small amount of personal property here, and paid its part-time employees approximately \$17,000 in wages during 1998. The \$17,000 in Indiana wages represents less than one-tenth of a percent of its payroll "everywhere." On the basis of this tenuous relationship, taxpayer proposes to include the telemarketing subsidiary within the Indiana consolidated return and – as a result – import into Indiana a portion of its telemarketing subsidiary's \$20,000,000 1998 losses. The Department is unable to conclude that such a result would fairly reflect taxpayer's Indiana adjusted gross income for 1998.

FINDING

Taxpayer's protest is respectfully denied.